



ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

**Friday, June 29, 2018
8:30 a.m.**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Kevin McCarthy, Chair of the ASRS Board, called the meeting to order at 8:31 a.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Kevin McCarthy, Chair
Mr. Tom Manos, Vice-chair
Mr. Jim Hillyard
Mr. Michael Miller
Mr. Clark Partridge

Excused: Mr. Rene Guillen
Mr. Michael Lofton

Two vacant positions.

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the April 27, 2018 Public Meeting and Executive Session of the ASRS Board

Motion: Mr. Clark Partridge moved to approve the minutes of the April 27, 2018 Public Meeting and Executive Session of the ASRS Board. Mr. Jim Hillyard seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved
Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

3. Presentation, Discussion, and Appropriate Action Regarding the ASRS 2018 Legislative Initiatives and Legislative Update

Ms. Jessica Thomas, Government Relations Officer, provided an update on the agency's legislative initiatives for 2018 and presented the 2018 Legislative Summary Book. She indicated that HB2034 and HB2035 had been signed by the Governor and staff will continue to work with the Governor's office regarding transferring the State Social Security Administrator duties to another state agency as necessary pursuant to HB2034. Ms. Thomas also provided an update on two bills affecting the ASRS: HB2258, related to the Diabetes Action Plan Team, and SB1524, related to budget reporting. She indicated that HB2258 requires the ASRS Director or the Director's designee to participate on the Diabetes Action Plan Team and SB1524 requires the ASRS to report its actuarial valuation and contribution rate for the upcoming fiscal year by December 1 each year. As such, the ASRS has scheduled its annual actuarial presentation for November this year.

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Program Updates

Mr. Karl Polen, Chief Investment Officer, opened the topic by providing the Board with a market update and reported that the Fund's current return for the year is approximately 9% with a market value of approximately \$39.8 billion.

The stock market continues to be volatile and the slight underweight in equities that the ASRS has maintained has increased. A rebalance of the Emerging Markets portfolio will be implemented next week in order to bring allocations closer to the target of 5.0%.

Mr. Polen confirmed that the preliminary results for March 31, 2018, provided at the last Board meeting, remained consistent when 100% of the data was returned. As of March 31, 2018, returns were at 11.45% and the one-year benchmark was 10.63%, so the outperformance was about 80 basis points (bps). Recent good market performance has resulted in bending the 10-year rolling return curve upward, but there is still a negative trend in the 20-year rolling average return. Mr. Polen noted the consistent and significant outperformance of Real Estate and Debt, each contributing \$3-4 hundred million to the excess performance enjoyed over the past 5 years.

Mr. Polen concluded with the risk report showing standard deviation of the portfolio at 12.80%, which is slightly lower than the Strategic Asset Allocation (SAA).

5. Presentation, Discussion, and Appropriate Action Regarding Proposed Changes to the ASRS Strategic Asset Allocation

Mr. Matson opened the discussion describing the asset allocation process, as well as NEPC's function as the Board's external resource for investment information, and emphasized that differences of opinion are welcomed and valuable. Mr. Matson then turned it over to Mr. Polen and Mr. Allen Martin, NEPC consultant, to review the SAA with the Board.

Mr. Martin began the presentation with the NEPC 2018 SAAP Review, and outlined the process used by Staff and NEPC to determine the recommended changes to the current SAA. He stressed the importance of this Board responsibility and the key to the future success of ASRS. Mr. Martin noted that NEPC updates its return forecasts annually and participates in a strategic asset allocation review for ASRS once every three to five years. He described the NEPC methods of analysis which include mean variance optimization, liquidity analysis, risk budgeting and scenario analysis. Mr. Martin explained the methods of mean variance optimization and the concept of an efficient frontier. Mr.

Martin described a target portfolio devised in cooperation with the ASRS investment team and an alternate portfolio. Mr. Martin noted that the target portfolio has a higher expected return and lower volatility compared to the current SAA.

Mr. Polen and Mr. Matson joined Mr. Martin in answering questions from members of the ASRS Board about the proposed SAA recommendations.

Motion: Mr. Clark Partridge moved to adopt the following policies from the Investment Strategy presentation as presented in the Board materials:

- Asset allocation and benchmark policy (page 15)
- Liquidity policy (page 31)
- Leverage policy (page 37)
- Implementation plans requirement (page 39)

These policies replace the previously adopted strategic asset allocation and asset class strategic plans for private equity, real estate and opportunistic investments. Mr. Michael Miller seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved
Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

6. Presentation, Discussion, and Appropriate Action Regarding Staff Recommended Updates to the ASRS Board Governance Policy Handbook

Mr. Matson provided background regarding the ASRS Board Governance Policy Handbook indicating its key relevance to the:

- A. Division of duties among staff, third parties, and Board, and
- B. Philosophy of separating decision-making and oversight.

With that in mind there are four key items that the Board retains decision-making authority for:

1. Hiring and firing the external auditor,
2. Hiring and firing the internal auditor,
3. Hiring and firing the general investment consultant, and
4. Hiring and firing the external actuary and actuarial auditor.

In addition to the above, there are two deviations from this model (i.e., that decision making and oversight are not the same). Currently the Board retains decision-making authority and oversight of the Strategic Asset Allocation and Health Insurance.

Mr. Matson reviewed the 3 most significant changes proposed by staff as follows:

- Page 6 – Added “when such duties reside at the ASRS.” This change was due to recent legislation authorizing the Governor to delegate these responsibilities to another State agency.

- Page 7 – Added Item #23 “Manage or oversee appeal settlements.”
- Pages 16-17 – Updated to reflect the new scope of work of the Internal Audit Division approved by the Board at the February 23, 2018 Board meeting.

Mr. McCarthy wanted to ensure consideration was given to statutes and rules when staff is recommending changes to the Board Governance Policy Handbook or administrative processes in general. Mr. Matson indicated a new project is being led by Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, that seeks to ensure the integration of legislation, rules, and administrative and organizational procedure.

Motion: Mr. Jim Hillyard moved to accept the revisions to the Board Governance Policy Handbook as presented. Mr. Tom Manos seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved
Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

7. Presentation, Discussion, and Appropriate Action Regarding Board Elections of Chair and Vice Chair

Prior to requesting nominations, Mr. McCarthy took a moment to thank his fellow Board members for allowing him the opportunity to serve as Chair this last year.

Motion: Mr. Kevin McCarthy moved to nominate Mr. Tom Manos as the ASRS Board Chair. Mr. Jim Hillyard seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved
Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

Motion: Mr. Tom Manos moved to nominate Mr. Jim Hillyard as the ASRS Board Vice-chair. Mr. Kevin McCarthy seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved

Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

8. Presentation, Discussion, and Appropriate Action Regarding Director's Report as well as Current Events

Mr. Paul Matson stated he had nothing further to add regarding the Director's Report, but would answer any questions the Board may have regarding the report; there were none.

9. Presentation and Discussion Regarding Informational Updates from Prior and Upcoming Committee Meetings

a. Operations, Audit and Legislative Committee (OALC)

Mr. Clark Partridge announced the next OALC meeting will be held on August 6, 2018.

b. Investment Committee (IC)

Mr. Clark Partridge announced the next regularly scheduled IC meeting is to be held on September 28, 2018.

c. Appeals Committee (AC)

Mr. Tom Manos announced the next AC meeting is scheduled to be held on August 14, 2018.

10. Board Requests for Future Agenda Items

No requests were made.

11. Call to the Public

No one from the public requested to speak.

12. The next regular ASRS Board meeting is scheduled for Friday, August 31 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

Mr. McCarthy noted the next Board meeting is scheduled for Friday, August 31, 2018 at 8:30 a.m.

13. Presentation, Discussion, and Appropriate Action Regarding Fiduciary Education

Ms. Jothi Beljan, Assistant Attorney General, reviewed Arizona Open Meeting Law, the applicable statutes, and their purpose, followed by a brief introduction of Fiduciary Duty.

Mr. McCarthy announced there would be a 10 minute recess while the meeting moved to the 14th floor conference room for the final agenda topic. Prior to moving the meeting to the 14th floor conference room, the following motion was made to move the final agenda item to executive session.

Motion: Mr. Jim Hillyard moved to go into Executive Session for the purpose of legal advice. Mr. Tom Manos seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 2 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Kevin McCarthy – approved
Mr. Tom Manos – approved
Mr. Rene Guillen – excused
Mr. Jim Hillyard – approved
Mr. Michael Lofton – excused
Mr. Michael Miller – approved
Mr. Clark Partridge – approved

The Board convened to Executive Session at 10:01 a.m.

The Board took a recess from 10:01 a.m. to 10:09 a.m. to transition to the 14th floor conference room for the final agenda topic and executive session.

14. Adjournment of the ASRS Board

The ASRS Board adjourned the June 29, 2018, public meeting and executive session of the Board at 11:21 a.m.

Respectfully Submitted by:

Joyce Williams
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM